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**FISCAL IMPACT STATEMENT**

**LS 6420**

**BILL NUMBER:** SB 558

**NOTE PREPARED:** Jan 12, 2005

**BILL AMENDED:**

**SUBJECT:** Military Income Tax Deduction.

**FIRST AUTHOR:** Sen. Mrvan

**BILL STATUS:** As Introduced

**FIRST SPONSOR:**

**FUNDS AFFECTED:** X GENERAL  
X DEDICATED  
FEDERAL

**IMPACT:** State & Local

**Summary of Legislation:** The bill provides an Income Tax deduction for all income (other than retirement income) derived from service in the armed forces in Afghanistan or Iraq, for taxable years beginning after December 31, 2002, and ending before January 1, 2008.

**Effective Date:** January 1, 2003 (retroactive).

**Explanation of State Expenditures:** The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this deduction. Under the bill, the deduction is effective beginning in tax year 2003. However, the deduction for tax year 2003 and tax year 2004 will have to be claimed in 2005 as 2004 tax forms have already been published and distributed. Tax year 2005 tax forms will have to be revised to include the deduction for both 2003, 2004, and 2005. The DOR's current level of resources should be sufficient to implement these changes.

**Explanation of State Revenues:** *Summary:* The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who serve in the military in Afghanistan or Iraq, and whose income earned from military service exceeds \$2,000. The deduction is applicable for tax years 2003 to 2007. The revenue loss due to this bill could potentially total about \$1.9 M in FY 2006.

Since eligible taxpayers have not been able to claim the deduction on their 2003 or 2004 tax returns, deductions for 2003, 2004, and 2005 would have to be claimed on the 2005 tax return. Thus, the fiscal impact in FY 2006 is a combination of three years of deductions (an estimated \$642,000 each year). This annual estimate is based

on personnel and pay totals during 2003, and assumes a similar incidence of Indiana residents serving in the military in Afghanistan and Iraq during 2004 and 2005. Totals for 2004 will be updated when information becomes available.

*Background:* The bill provides for a deduction from AGI of all income in excess of the current \$2,000 military deduction received during the taxable year, for service in Afghanistan or Iraq. The deduction could be claimed for such income earned in tax years 2003 through 2007. This deduction could be claimed by a qualifying taxpayer in addition to the existing \$2,000 maximum allowable deduction for military service pay.

According to the Defense Manpower Data Center, 2,499 enlisted personnel and 147 officers (including warrant officers) reporting Indiana as their state of residence to the Internal Revenue Service served outside the U.S. and its territories during 2003, with annual taxable income estimated at about \$50.3 M. It is estimated that approximately \$5.3 M of this income would be deductible under the current \$2,000 military service pay deduction. Thus, the net deduction for all Indiana residents serving in the military outside the U.S. and its territories during 2003 is estimated to total about \$45.0 M. Based on active duty strength levels by region reported by the U.S. Department of Defense, it is estimated that about 42% of the overseas military personnel are serving in and around Iraq. Strength levels in Afghanistan are not available. Assuming 42% of the Indiana residents serving overseas are serving in Iraq, the annual deduction amount for these individuals could potentially total about \$18.9 M. The tax impact of the deduction amount would be approximately \$642,000. The fiscal impact could fall above or below this total to the extent that personnel overseas are serving in Afghanistan or don't serve for the entire year in either Iraq or Afghanistan.

The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** Because the proposed deduction would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties with a local option income tax.

**Information Sources:** Deborah Williamson, Defense Manpower Data Center, 831-583-2400. U.S. Department of Defense, *Active Duty Military Personnel Strengths by Regional Area and By Country (309A)*, September 30, 2003, <http://web1.whs.osd.mil/mmids/mmidshome.htm>.

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